Cost-of-Living Adjustments

- Since 1975, Social Security’s general benefit increases have been based on increases in the cost of living, as measured by the Consumer Price Index (CPI).
- These Cost-of-Living Adjustments (COLAs) are effective with benefits payable for December.
- Social Security benefits keep pace with inflation.
- COLA cannot be less than zero.
- Example: If initial PIA is $1,444.50 and it is increased by 0.3-percent COLA, the new PIA (truncated to the next lower dime) is $1,448.80.
Consumer Price Index (CPI)

- Bureau of Labor Statistics produces monthly data on changes in prices paid for a representative basket of goods and services.
- Social Security benefit COLAs are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).
- COLA = percentage increase (if any) in the average CPI-W from Q3 of the last year with non-zero COLA to Q3 of current year.
- 2016 (235.057) is 0.3% increase from 2014 (234.242).
## COLA series, 1975-2016

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Simple, right?

- Bureau of Labor Statistics produces monthly data on changes in prices paid for a representative basket of goods and services

- CPI-W (and CPI-U) based on experience of the relevant average household (spending habits survey of 7,000 families)

- Other indices, other approaches
Chained CPI (C-CPI-U)

- Based on idea that in an inflationary environment, consumers will choose less-expensive substitutes.
- All indices correct for “lower-level substitution bias” (Red Delicious instead of Granny Smith) but not “higher-level substitution bias” (apples vs iPhones).
- CPI-W (and CPI-U) weights are adjusted every two years, but C-CPI-U is impacted the next month.
- By age 85, benefits would be about 6.5% lower.
- OCACT estimates C-CPI-U would reduce the annual COLA by 0.3 percentage point, on average.
CPI for the Elderly (CPI-E)

- Basket of goods and services for those age 62+
- Certain expenditure groups, such as medical care and housing, are given greater weight (10.8% in CPI-E vs. 5.3% in CPI-W)
- Medical care costs historically rise faster than inflation
- By age 85, benefits would be about 4.6% higher
- OCACT estimates CPI-E would increase the annual COLA by 0.2 percentage point, on average
Other variations

- Proposals to reduce or increase annual COLA (as currently calculated) by a set amount
- Chained CPI-W, chained CPI-E
- Hold disabled (DI), lower earners harmless
- No COLA for high earners
- Different indices for different benefit amounts or earnings levels
So what?

- Changes to the COLA would have greater impact on long-range actuarial balance than you might think
- Switching from CPI-W to chained CPI-W starting December 2017 = 21% of shortfall eliminated
- Switching from CPI-W to CPI-E starting December 2018 = 14% increase in shortfall
- Reducing the annual COLA by 1 percentage point starting December 2017 = 66% of shortfall eliminated
- Present law shortfall in long-range actuarial balance is 2.83 percent of payroll (2017 Trustees Report)
Resources

- 150+ provisions scored annually: https://www.ssa.gov/oact/solvency/provisions/index.html

- Cost-of-living adjustment provisions: https://www.ssa.gov/oact/solvency/provisions/cola.html